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IN THE

Supreme Court of the United States

NO. 10

OCTOBER TERM, 1936

JOSEPH H. BARWISE AND GEORGE THOMPSON, JR.
As Trustees of the Estate of Mrs. M. M.
(W. I.) Cook, Deceased.

Appellants

VS.

GEORGE H. SHEPPARD,
Comptroller of the State of Texas, Et Al

Appellees

APPEAL FROM THE COURT OF CIVIL APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS

APPELLEES' SUBSTITUTE BRIEF

WILLIAM MCCRAW,
Attorney General of Texas

H. GRADY CHANDLER,
Assistant Attorney General

LLEWELLYN B. DUKE,
Assistant Attorney General

ATTORNEYS FOR APPELLEES

ELLIOTT PRINTING CO.—*Austin*

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(Reported 89 S. W. (2d) 1021 and 1026)

APPELLEES' SUBSTITUTE BRIEF

PRELIMINARY STATEMENT

At the last term of the Court, we filed a brief, hurriedly prepared in anticipation of an early setting, and without the benefit of appellants' brief, not then filed.

We have now been furnished with a copy of the latter; and we wish to substitute this for our former brief. We take it that it will be unnecessary for the Court to now consider the superseded brief.

We accept as substantially correct appellants' statement of the case, and the statutes and constitutional provisions, as set out in Appendix "A", "B", "C" and "D", pps. 32-56 of their brief.

The statement of the history of the suit, the pleadings, the substance of the material facts and the steps in the course of the appeal have all been fairly and adequately presented. We have no complaint on that score, although differing with counsel on the meaning and proper interpretation of certain stipulations upon which the case was tried. They refer to the relation of appellants to the business sought to be taxed and their real interest therein, and to the effect of the phrase "free of cost", as used in the contracts. The effect of these stipulations is briefly, but clearly, stated in the opinions of the Court below.

On page 12 of appellants' brief, we find a quotation in italics from the agreed Statement of Facts. Considered alone, it might be thought to sustain one of the points strongly relied upon; namely, that the statute, as applied, declared appellants to be producers, contrary to the fact and in violation of the stipulations of the case. We refer the Court to the opinions of the Court of Civil Appeals, wherein, in substance, it is held that the paragraph must be construed and considered along with the terms of the leases and all other admitted facts. So considered, it was properly held to

mean no more than that appellants were not *actively* operating or conducting the business; but that their interest therein and in the profits and success of the enterprise was real, direct and substantial. This and the other facts of record were considered as being sufficient to apply the law to appellants as producers within the meaning of the statute.

JURISDICTIONAL QUESTION

This case involves the validity of a tax statute of the State of Texas, challenged upon several grounds as violative of the Constitution of the United States. The salient and relevant parts of the statute, with convenient references, will be set out hereafter. We now have the benefit of appellants' brief in this Court. Their contentions are practically the same as made in the state courts, limited, of course, to the much narrower ground remaining after adverse decisions in the state courts on questions determinable and actually decided under the local law. The inquiry has been further limited by the abandonment by appellants of many questions raised below, as indicated in their statement of the points upon which they intend to rely here. (R. 60-61).

The grounds for jurisdiction in this Court are stated by appellants in the document styled: "Statement as to Jurisdiction", and in the beginning of their brief. While we have not formally challenged the jurisdiction of the Supreme Court, and while perhaps that course is not now open to us, we take it that the Court will exercise its power to refuse a decision on the merits, if of the opinion that no substantial Federal question

has been raised. It goes without saying that neither waiver nor consent of the parties can confer jurisdiction if none exists. We hesitate to say that the Federal questions sought to be raised here are frivolous and that, therefore, the case should be dismissed; but our doubts persist and we should be wanting in frankness if we did not say so. Upon the assumption, however, that the case is properly here for decision on the merits, we shall attempt to answer every point upon which appellants rely for a reversal of the decisions of the state courts.

ISSUES INVOLVED

To clear the way for the discussion of the points now remaining, we think it of some importance to call the attention of the Court to the fact that a number of questions arising under the State constitution and laws were raised below; but they were all decided adversely to appellants. 89 S. W. Rep. (2d) 1021-1028. Since they were all determinable by the local law and were actually decided by the State courts, it would seem that they are no longer in the case. They are thought to be concluded by the decisions and the interpretations placed by the State courts upon their own constitution, which are generally held to be binding upon the Federal courts. Furthermore, all such questions have been removed from controversy by the election of appellants to now rely solely upon the due process clause of the Fourteenth Amendment to the Constitution of the United States, and upon Section Ten of Article One of the Constitution, prohibiting any state from passing any law impairing the obligations of contracts. The Fifth Amendment is not here

involved, since it is well settled that it is a limitation alone upon the Federal power. What was said in our former brief concerning that Amendment was historical and for possible analogies in the purposes of adoption. We meant to imply nothing more. Nor do we understand that appellants have ever made any claim that the Fifth Amendment had been infringed by the legislation in question.

We think it will be conducive to the Court's convenience to make our replies to appellants' contentions under two headings: Due Process and Contract Obligations. Before proceeding to the discussion, it will make for convenience also to here set out the relevant provisions of the statute:

Approved May 22, 1933, it is an Act of the Legislature of Texas, known as House Bill 154, Chapter 162, Acts 43rd Legislature, Regular Session, page 409; effective August 29, 1933. It is a general revenue act, laying taxes not only on the business of producing oil, but on other unrelated occupations; the latter, of course, being irrelevant to this inquiry. We now quote the relevant parts: "There is hereby levied an occupation tax on oil produced within this State of two (2) cents per barrel of forty-two (42) standard gallons . . .". *Section* 2 (I)

"The tax hereby levied shall be a liability of the producer of oil and it shall be the duty of such producer to keep accurate records of all oil produced, making monthly reports under oath as hereinafter provided" *Section* 2 (2). "The purchaser of oil shall pay the tax on all oil purchased and deduct tax so paid from the payment due producer or other interest

holder, making such payments so deducted to the Comptroller of Public Accounts by legal tender or cashier's check payable to the State Treasury. Provided, that if oil produced is not sold during the month in which produced, then said producer shall pay the tax at the same rate and in the manner as if said oil were sold" *Section* 2 (3). "The tax herein levied shall be borne ratably by all interested parties, including royalty interests; and producers and/or purchasers of oil are hereby authorized to withhold from any payments due interested parties, the proportionate tax due." *Section* 2 (6).

It is not deemed necessary to set out any of the provisions of the Amendatory Act of the First Called Session, Chapter 12, as its effect is substantially stated in Appellants' Brief, p. 10.

A statute passed at the same session of the Legislature, being Chapter 214, and being found at page 637, Acts 43rd Legislature, Regular Session, provides the remedy for complaining taxpayers, through judicial processes. This Act, in substance, provides that any person wishing to contest the validity of the tax, or upon any other ground, may pay the same under protest. The administrative officers of the State are thereupon required to place the particular taxes involved in a special account, to abide the result of the litigation; and they are further required to put such funds out at interest in State depositaries, to draw the same rate of interest as State funds. The Act further provides a convenient forum for suits, including class suits, and expressly confers the right of appeal. If the complainant is successful, the law provides for a refund of the taxes withheld, with earned interest.

DUE PROCESS

We now proceed to the discussion of appellants' contentions. As to the claim that they have been denied due process of law, as guaranteed by the Fourteenth Amendment, there is, we take it, no fairer way to state them than to quote their exact words in specifying the points upon which they intend to rely. (R. 60-61):

1. "It being an admitted fact that the appellants are not engaged in the business of producing oil, the Texas Gross Production Tax law of 1933, as Amended, which arbitrarily provides that they are engaged in such business, to lay an otherwise prohibited tax upon them, contravenes the due process clause of the Fourteenth Amendment to the Federal Constitution."

2. "Appellants antecedent lease having obligated the lessees to deliver appellants' royalty oil to their credit in the pipe line free of cost, the tax law in question which authorizes and requires the deduction of two per cent of the proceeds of appellants' oil and the addition of a like amount to the proceeds of their lessee's oil, makes the appellants' royalty interest less valuable, and the method of enforcing the lease entirely different than when it was made, violates the due process clause of the Fourteenth Amendment to, and the obligation of contract clause of the Federal Constitution."

It may serve a useful purpose to cite some of the decisions of this Court, and to quote from other high

sources, upon what is due process, within the meaning of the Constitution.

Mr. Webster, in his justly celebrated argument in the Dartmouth College case, defined it thus: "As applied to judicial proceedings, due process of law means a law which hears before it condemns; which proceeds upon inquiry, and renders judgment only after trial".

Perhaps the most widely accepted definition is that of Judge Cooley: "Due process of law in each particular case means such an exertion of the powers of government as the settled maxims of law permit and sanction, and under such safeguards for the protection of individual rights as those maxims prescribe for the class of cases to which the one in question belongs".

Another definition, by this Court: "Due process of law, within the meaning of the Fourteenth Amendment, is secured if the laws operate upon all alike, and do not subject the individual to an arbitrary exercise of the powers of government". Leeper vs. Texas, 139 U. S. 468.

Still another: "Due process of law is so secured by laws operating upon all alike and not subjecting the individual to the arbitrary fiat of the power of government, unrestrained by the established principles of private right and distributive justice". Caldwell vs. Texas, 137 U. S., 697.

In our former brief, 11-14, we cited and quoted from several decisions by this Court, especially applicable to the taxing powers of the states, and to the limits of the restraints thereon found in the Fourteenth

Amendment. They are: McMillan vs. Anderson, 95 U. S. 37; Wade vs. Travis County, 174 U. S., 499; St. Louis vs. The Ferry Co., 11 Wall., 423; Kirtland vs. Hotchkiss, 100 U. S. 491; Memphis Gas Light Co. vs. Taxing District of Shelby County, 109 U. S., 398; State Tax on Foreign held bonds, 15 Wall., 319. We ask the Court to give them due consideration; and we cannot refrain from repeating the admirable condensation of the rule, as stated in State Tax on Foreign-held Bonds, supra: "Unless restrained by the provisions of the federal constitution the power of the state as to the mode, form and extent of taxation is unlimited where the objects to which it apprises are within her jurisdiction."

It was said in the case of Del Castillo vs. McConnico, 168 U. S. 674, that the federal courts derive no general jurisdiction from the 14th Amendment to the Federal Constitution to prevent or to relieve from oppression under states laws or to correct errors or mistakes of detail in state administration. Errors in the administration of a tax statute, not jurisdictional in character, will not justify the Federal Supreme Court in holding that the state has deprived or is about to deprive the complaining party of his property without due process of law. Lent vs. Tillson, 140 U. S. 316.

The 14th Amendment of the Federal Constitution, in declaring that no state shall deprive any person of property without due process of law, does not limit the taxing power of the states whatever the methods devised for the purpose of taxation, unless such methods by their necessary operation are inconsistent with the fundamental principles embraced by the re-

quirements of due process of law. Southwestern Oil Co. vs. Texas, 217 U. S. 114.

In French vs. Barber Asphalt Paving Co., 181 U. S. 324, the court said:

> "It was not the intention of the 14th Amendment to subvert the systems of the states pertaining to general and special taxation; that amendment legitimately operates to extend to the citizens and residents of the states, the same protection against arbitrary state legislation, affecting life, liberty, and property, as is afforded by the Fifth Amendment against similar legislation by Congress, and the Federal Courts ought not to interfere when what is complained of is the enforcement of the settled laws of the State, applicable to all persons in like circumstances and conditions, but only when there is some abuse of law, amounting to confiscation of property or deprivation of personal rights."

State cases upon which we rely are the following:

In the case of Flynn, Welch & Yates v. State Tax Commission, 28 Pac. (2d) 889, the Supreme Court of the State of New Mexico said in part:

> "Our minds do not reject the idea that the lessee and the royalty owner are considered as participating in a joint enterprise or both engaged in the business of producing or severing oil and that the tax is therefore essentially occupational. Such a view, however, is not indispensable to sustaining the tax. For it may be considered occupational as to the lessees and another kind of tax as to the royalty owner. Unless found as to one or the other to be a tax upon tangible property it need not be levied ad valorem and is excise."

The foregoing declaration of the Supreme Court of New Mexico was made at a time when the Supreme Court of that state had before it an attack upon the constitutionality of a statute of the State of New Mexico which is almost verbatim the same as the statute of the State of Texas which is now under attack by appellants.

Speaking further, and at the same time the Supreme Court of New Mexico said:

> "One cannot read the tax decision of the courts of last resort, state and federal, and fail to note an increasing resort for revenue to the occasion when the owner realizes upon the natural resources embraced within his land holding and by so doing depletes the taxable resources of the State."

We know of no state in the union whose wealth consists of rich natural resources that there is not some nature of tax upon the business of taking the minerals from the soil. The theory adopted uniformly by the states is that when once the vast stores of natural resources have been exhausted the otherwise taxable wealth of the state is gone; therefore, those who profit by the mining or production of minerals should contribute to the support of the government during the time when the minerals are being severed from the soil. Upon this theory appellants should be taxed for the reason that they will share in the profits of the exploitation of the minerals upon their land holdings in proportion to what they have invested as will the actual producer of such oil or other minerals. We think it may well be said in this case, as was said in the New

Mexico case, that appellants were jointly engaged with the lessees operating upon appellants' land.

In State vs. State Board of Equalization, 17 Pac. (2d) 68, the Supreme Court of Montana said, in effect:

> "Your operations deplete the natural resources of the State and to the extent that you remove from the earth the natural wealth with which nature has provided it and to that extent impoverish it, you are required to pay a license tax for the use and benefit of the state for the privilege of extracting such natural wealth. The tax provided is not, therefore, on metals, minerals or mined products, but rather upon the business of producing metals or precious stones based upon annual production."

An all-comprehensive definition of due process, decisive of all cases, is difficult to find; and this Court more than once has said that it is unnecessary and, perhaps, inadvisable to make the attempt. With no little confidence, however, we submit that the above cited definitions are sufficiently enlightening to decide this controversy. With their aid, let us proceed to examine appellants' claims.

The first point to be considered, we think, is the contention that the statute in question denies due process because of supposed arbitrary features therein, as applied to appellants. In reply, we assert that it would be difficult to find a law so solicitous for the rights of those subjected to its burdens. In respect to the remedy, it is almost meticulous in its processes and safeguards. A judicial hearing, adequate, comprehensive,

complete, is assured by its express terms; as indicated by the summary of the remedial statute, passed at the same session, as stated above. It would almost seem that the Legislature had due process of law directly and immediately in mind in passing these statutes. Certainly there is nothing lacking to make it what Webster conceived was due process of law: "A law which hears before it condemns; which proceeds upon inquiry, and renders judgment only after trial." We apprehend, however, that appellants will say that all this is beside the point; because these considerations go only to the matter of remedy, whereas their complaints are levelled at the substantive provisions of the law. We have no disposition to evade the issue. We shall meet the challenge upon that ground.

Before entering upon a detailed discussion, however, we again invoke the rule stated in Caldwell vs. Texas, supra: "Due process of law is so secured by laws operating upon all alike and not subjecting the individual to the arbitrary fiat of the government, unrestained by the established principles of private right and distributive justice". The language seems singularly applicable to the situation here. The tax statute, as revealed by even the most casual reading, operates upon all alike, within the just and reasonable classification of all owners of interests as producers, taxing each according to his actual interest. None of the incidences bears unreasonably upon any person or any class within its purview. None is subjected to the arbitrary fiat of the government, but the objects of the law bear a reasonable relation to the position of every owner of the business or the production taxed. In making the respective owners pay their proportion of

the tax, ratably, there is not only no denial of established principles of private right and distributive justice, but a clear recognition and enforcement of them.

We are not unmindful of the danger of employing generalizations, no matter how high the sources from which they come, as precedents to support contentions in another case. We recall the observation of Chief Justice Marshall, in Cohens vs. Virginia: "It is a maxim not to be disregarded that general expressions, in every opinion, are to be taken in connection with the case in which these expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision." If we have quoted or shall quote general statements not called for by the facts or issues of the case, it has not been by design. In each instance, we have thought the case sufficiently analogous and the quotation sufficiently appropriate to be of some value in the present inquiry. The learning and discrimination of your Honors can be relied upon to reject any specious references. These remarks are anticipatory; and while we are upon the subject, it may be remarked that the rule is not unilateral. It applies as well to general expressions cited by appellants. When convinced they are *dicta* or not in point, we shall freely state our differentiations. Appellants, of course, may do likewise.

Coming specifically to consider appellants' contentions under due process, we first take up the matter of the character of the tax. It is not deemed of any great importance to precisely describe the tax here imposed. We are of the opinion that it is best character-

ized as an occupation tax, having been levied upon the business of producing oil and measured according to the amount of oil produced, and ratably and proportionately against the owners of same. Although clearly occupational in character, it properly falls within the general classification of an excise, considered as either occupation, privilege or license tax. As stated by this Court in Hylton vs. The United States, 3 Wall. 171, the word "excise" has no precise meaning.

Having the general character of an excise, it was not necessary for the Legislature to classify or designate royalty owners as producers of oil, in order to validly tax them. It was sufficient, to differentiate the tax from a property tax, that the several owners of the oil, when severed from the soil and brought to the surface should be taxed in proportion to their interests in the production. The tax might well be regarded as one kind as to the active producer and another as to the royalty owner. It is clear that the Legislature did not intend to impose a property tax; least of all a tax upon the realty. The State courts so determined, when provisions of the Texas Constitution were invoked. Thus many of appellants' contentions are met.

Further pursuing the inquiry, in determining the character of the tax the true test is, not the name by which it is known, but the incidences of the tax. This rule has been frequently applied by this Court, and was recognized by the State court. The Legislature, however, called the tax an "occupation tax". While concededly not controlling, the legislative understanding is of importance. As was said by this Court, in Flint vs. Stone Tracy Company, 220 U. S. 145: "While

the mere declaration contained in a statute that it shall be regarded as a tax of a particular character does not make it such, the declaration of the law making power is entitled to much weight." In any event, if the tax is sustainable as being a proper exercise of the taxing power of the State, the fact, if it be a fact, that the Legislature gave it a mistaken or inappropriate name is wholly immaterial. Tested alone by its incidences, as appellants insist it must be, it reasonably appears to be a tax upon the business of producing oil. The many provisions relating to the imposition of the tax, the determination of the amount of oil produced and handled, the amount of the tax in every given case, the duties of the active producer in the matter of keeping records and making reports and the deductions and payments by purchasers, all bear directly and immediately upon the business. In levying the tax against the various interest holders in the oil produced, including the active producers and the royalty owners, the State court held that the legislature could validly declare the owners of royalty interests in the oil produced to be engaged in the occupation and business of producing oil. The State Constitution expressly authorizes the Legislature to levy occupation taxes. Therefore, it would seem that the question has been conclusively settled against appellants' contention, under the local law, as interpreted by the courts of the State. The power of the states to levy occupation taxes is not prohibited by the Fourteenth Amendment nor any other provision of the Federal Constitution of which we are aware. If not, it is difficult to see how any constitutional right of appellants has been infringed by the exercise of that power in respect to a business as to

which it is at least debatable whether every person having an interest therein, by way of royalties, or otherwise, is in fact engaged in the business.

Since it is insisted that the tax cannot be sustained, as to appellants, upon the theory that they are producers; because they in fact are not such, as has been expressly stipulated, and that the Legislature could not make them producers contrary to the fact, we feel impelled to examine the point a little more closely. We do not wish to evade in the slightest the force of our agreement, as disclosed by the Record. We stand by it fully, but it was made with reference to and in the light of other agreed facts, including the implied covenants of the leases. When all the facts and considerations and the circumstances relating to the production of oil are fully weighed, the stipulation means no more than that appellants are not producers, as that term is commonly understood. They do not actually produce the oil, but their interest in the business, as royalty owners, is such that the Legislature could reasonably adopt it as one of the bases of the classification. The leases are set out in the Transcript (R. 19-25). They are in the usual form of oil leases. The effect of these lease contracts was to make lessor and lessee partners in a joint enterprise, with different interests, it is true, but each having a direct interest in the success of the business. They are as truly partners as if named in the leases as such; not as general partners, but as to the particular undertaking. And the lessor is not even a silent partner, the leases appearing of record. For all practical purposes, he is, to the extent of his interest, engaged in the business of producing oil; and the Leg-

islature, in taxing such business, properly took his interest into account and taxed it ratably. That the active duties of production were imposed upon the lessee is not of controlling importance. As was aptly said by the Court of Civil Appeals (R.53):

> "We are also clear in the view that for the purpose of levying the gross production tax on the occupation or business of producing oil, the Legislature may validly declare the owners of royalty or other interests in the oil produced to be engaged in the occupation or business of producing oil. The ordinary form of oil lease has a dual character or purpose: 1. The conveyance of an estate in the land for development purposes; and 2. the future development and operation of the lease for oil in accordance with the terms (fol.66) express and implied, of the contract for the mutual benefit of the parties, their respective benefit being measured by the extent of their interests in the oil produced, or its value. The law is settled that the primary objective of the oil lease is the production of oil for the mutual profit of the parties. The consideration moving to the lessor is an interest in the oil or its value in money. Thus he has a direct interest in the success of the business. As the holder of the royalty interest the lessor or royalty owner is not only entitled to share in the gross production of the oil but may under the terms of the lease, express or implied, require proper, prudent and diligent management and development of the business, and has reserved and is entitled to both legal and equitable remedies necessary to enforce the obligations of the lease, and under some circumstances may forfeit the lease for non-development. Texas Co. vs. Davis, 113 Tex., 321; Robinson vs. Jacobs, 113 Tex., 231;

Thomason vs. Ham, 113 Tex., 238; Munsey vs. Marnet Oil and Gas Company, 113 Tex., 212."

We are not now concerned with technical partnerships, but only with finding a reasonable basis of support for the classification made by the Legislature, in treating royalty owners as part owners in the business of producing oil, along with all other owners. We have sought to regard substance rather than form, as, no doubt, did the Legislature. So viewed, we have no doubt that the true relation of holders of royalty interests to the business was ample warrant to class them, along with the active producer, as producers of oil; as was expressly done in Sections 2(2) and 2(6), considered together.

While convinced that the tax in question is an occupation tax, as declared by the Legislature and as decided by the State courts, we are not averse to discussing the legal effect if it should be regarded as a property tax. As we view it, the appellants would be little, if any, better off on that assumption. The right of the states to tax property within their limits has long since been settled beyond cavil. Indeed, it is a right inherent in the sovereignty. Texas has expressly recognized and authorized the exercise of this power in her constitution. Certain limitations on the power are also to be found in the Constitution, but the lower courts, in this case, have found adversely to appellants' contentions that these limitations have been violated. These holdings, predicated as they are upon the local law, are thought to be controlling on this point and binding upon this Court. If the question were still open, however, it must be limited to supposed infringe-

ments of the Fourteenth Amendment. Appellants, in bringing their case here, have so narrowed their claim. (R.61). The claims of impairment of contract obligations are upon different grounds, as we view them, and will be considered further on.

So we come to consider the restraints of the Fourteenth Amendment as they relate to the validity of this tax statute, considered as a property tax. We confess to great difficulty in finding even the narrowest ground for argument. There are no requirements in the Amendment, even by implication, for uniformity, equaltity or the amount of tax a state may impose upon property within her limits. It has long been settled law in Texas, as held by the Court of Civil Appeals, and the authorities cited in its opinions, that oil when raised to the surface and severed from the soil becomes personal property. Considered as a tax upon such property, wherein has any constitutional right of appellants been violated? The classification of royalty owners with other owners, for the purposes of the tax, does not, of itself, present any constitutional question under the Fourteenth Amendment. The claim of denial of the equal protection of the laws has been abandoned and need not be considered. The terms of the statute, from caption to emergency clause, reveal not a single element of inequality, discrimination, confiscation, injustice nor other supposed constitutional vice. It is surprisingly well drawn, and, seemingly, scrupulously fashioned to provide due process of law. If the Legislature failed in this regard, it must be because of inherent difficulties. There is nothing arbitrary in classing royalty owners as part owners of the oil pro-

duced where, as here, their very contracts make them indisputably such; and the limitations that they are to be taxed ratably and according to their interests only would seem to meet every constitutional requirement, even if it should be assumed that the Legislature has given the tax an inappropriate name. The courts of the State are expressly declared open to any citizen wishing to test the validity of the law, with right of appeal as in other cases; and their property and rights fully protected, pending the final disposition of suit. Even class suits, with their manifest advantages to all who are not active litigants, are authorized. The conclusion is ineluctable that, substantively and remedially, the statute does not offend against the Fourteenth Amendment.

A further contention of appellants is that the tax is void, as applied to th[illegible]ecause it lessens their income from the oil production covered by their contracts; and further, that the statute, as applied takes a part of their property and, in effect, gives it to their lessees. These propositions are more appropriately referable to their claim of impairment of contract obligations, and we shall treat them more fully under that head. However, since they are included in their invocation of the due process clause, we shall pause long enough to briefly give our answer here. As to depletion of income, by the imposition of the tax, we must be excused for saying that that is one of the unpleasant, indeed inevitable, things about all taxes. They will cut into our income, but that presents no legal question. The second point is even more untenable, if possible. The fact that under prior laws

the lessee, that is the active producer, was required to pay all the tax, although he might own less than the whole of the production (usually 7/8) and that under the present statute he pays only proportionately, according to his actual interest, falls far short of demonstrating that the appellants' property has been taken and conferred upon another. The share of the tax appellants now pay, as royalty owners, belongs to the State and to the State alone. The fact that the active producer has benefitted by the change in legislative policy is entirely beside the question. The new legislation seems to be nothing more than a belated recognition of the injustice of the old. These considerations, briefly stated, should be sufficient to show that due process has not been even remotely denied, in the particulars claimed. As stated they will be discussed more fully under the claim of contract impairments.

CONTRACT OBLIGATIONS

We now pass to the claims of impairment of contract obligation. Appellants assert that because of antecedent contracts, to which neither the State nor appellees were parties, the hands of the State were stayed and its taxing power subordinated to their private contracts; merely because their income from the particular enterprise was reduced by the necessary operation of the statute under consideration, and the further claim that the other parties to the contracts were benefitted by the change in legislative policy. If this were true, it would not suffice to destroy the statute; but the very novelty of the claim attracts. No ap-

plicable authority is cited, and the extent of the implications serves to refute the proposition. It really goes to the point that private contracts may have the effect of restraining the right of the States to exercise its taxing power to tax the business of using and enjoying its richest natural resource, through otherwise valid and lawful enactments. The contract clause of the Constitution contains no such limitation. To hold that it does would be to virtually destroy the taxing power over many subjects of taxation, to which the states are constantly and progressively resorting for revenue and as compensation for draining their natural resources. This Court, in Murray vs. Charleston, 96 U.S., 444; 24 L. Ed. 760 (a case cited by appellants) has said: "We do not question the existence of a State power to levy taxes as claimed, nor the subordination of contracts to it, so far as it is unrestrained by constitutional limitation." The mere assertion that contract obligations have been violated is not enough. It must be made to appear that the law under attack, in its necessary or enforced operation, alters the terms of a contract by imposing new conditions or depriving the parties of the means which the law in existence at the time of the contract afforded for its enforcement.

We apprehend that appellants, nevertheless, will insist that, notwithstanding the subordination of contracts to the taxing power generally, their case presents an exception and a limitation on that power, because the statute impairs the obligations of their contracts, in violation of the Constitution of the United States. The precise point, as we understand it, is that the law in question authorized and requires the deduction of a

part of the proceeds of their oil and gives the lessee the benefit of such deductions; in violation of a term of the contracts, whereby it was expressly stipulated that the lessee should bear the burden of the entire tax, by virtue alone of a provision therein that the lessee should delivet appellants' share of the oil or its proceeds, "free of cost". This contention requires a consideration of the terms and effect of the contracts, and whether any obligation thereof has been impaired by the statute, within the meaning of the Constitution. To this there are several answers.

We insist that the obligation of the contracts claimed to have been changed by the terms and effect of the statute has neither been impaired nor affected by the law. First, we deny that the contracts relieved appellants of the duty of paying their share of any tax the State might thereafter impose. Such an effect is claimed solely because of the inclusion of the phrase "free of cost". In the contracts, no specific reference is made to taxes. Indeed, they were not even in contemplation of the parties; therefore, no obligation in reference thereto was imposed. The tax statute in effect at the time of the contracts levied no tax upon the interest of royalty owners. It was wholly upon the active, operating producer; and he was required to pay the entire tax, notwithstanding he might own less than the whole of the production. This policy was changed by the Legislature in the enactment of the statute here assailed. It is difficult to perceive that the tax burden, now for the first time laid upon the royalty owner, according to his proportionate interest, was within the contemplation of the parties or intended to be included by the use of the phrase aforesaid.

To so infer is to impute to them a quality of prescience that would be truly remarkable; especially since there is nothing to show that a future legislature or legislators had in mind any change in legislative policy. If future taxes to be levied upon appellants were not in the minds of the parties, how can it be said that an obligation with relation thereto was created? If not, there was no obligation with respect thereto to be impaired. It is not claimed that any other term of the contracts had the effect of placing upon the lessee the duty of paying future taxes laid upon appellants.

We think the phrase "free of cost", as used in the contracts, must be taken to mean the usual costs of production; such as providing machinery, labor, drilling operations, bringing the oil to the surface, handling and saving, delivery to pipelines and other expense incidental to the actual production and marketing of oil. The payment of taxes is not ordinarily an expense of production; especially, we think, taxes imposed upon some one other than the producer, as commonly understood. Such an item would not be brought within the contract, unless specified; and the general phrase relied upon is, in our opinion, not sufficient for that purpose. Especially is this true, when constitutional limitations are urged to destroy the effect of a tax statute; and where the burden is upon the party assailing it, to point out the very contract obligation which it is said has been impaired. In such a case no doubtful constructions will be admissible. Hence we say that no obligation with reference to the payment of appellants' taxes was embraced in the contracts and, therefore, no such obligation impaired.

As we have said before, and we still maintain, appellants might just as soundly contend that the lessee under the contracts, could be required to pay the ad valorem tax upon appellants' realty, consisting of the undiscovered and undetermined minerals, as one of the costs incidental to the production of oil, as to make the claim that any future tax which the State of Texas might see fit to levy upon appellants, as an excise, should be borne by the lessee. We also reiterate that the tax now required by the laws of the State of Texas to be paid by appellants is no more a cost incident to that production than is the ad valorem upon a farm an incident to the cost of production of agricultural products. It will certainly not be contended that a tenant farmer, having a contract with his landlord to deliver, free of cost, every fourth bale of cotton (a practice common to such relations) assumes the obligation to pay all or any part of the landlord's taxes, by virtue of the clause relating to costs. Where is the difference in principle? We would not consciously bolster our arguments with fanciful analogies, nor with arguments and illustrations drawn from extremes. We think those just suggested are well within the spirit of the point under discussion.

Next, we reply that even if the agreement of the lessee to deliver appellants' share of the oil produced from their lands, free of cost, included the obligation to pay taxes of the lessor, still there has been no impairment of that obligation by the statute in question. If a tax not imposed and not contemplated at the time of the contracts could be said to be within the purview of the contracts, this statute does not affect the ob-

ligation. As was said by the Court of Civil Appeals: (R.56): "Manifestly this taxing act does not change in any manner the lease contracts between the parties. The tax is not against the oil royalty. It is levied as a gross production tax on the business or occupation of producing oil". It may be added that the statute does not affect the contracts at all. They remain exactly as before. If the lessor had succeeded, by the terms of the contracts or by their general effect, in obligating the lessee to pay all taxes, present or future, including those of appellants, what is there in the statute to prevent the enforcement of the obligation? It approaches subtlety to say that a mere change in legislative policy, whereby each owner of interests in the business of producing oil is made to bear his just share of the tax, relieves a party to the contract of his obligation to discharge a burden which he had voluntarily assumed. This belated recognition by the Legislature of the injustice of requiring a part owner of the business to pay all the tax affords no ground for saying that it was intended or has the effect of relieving such party of his contract obligation. The new policy is entirely independent of contracts, and all the provisions of the statute operate to enforce that policy, as between the state and each owner of interests in the business. By this we mean that there is nothing in the record to suggest that the Legislature had any purpose to disturb existing contracts; yet we do not concede that it did not have the power to do so, if it had deemed it necessary in order to bring its tax system into a just relation with its citizens, and to insure distributive justice.

It is even more unconvincing to assert, as appellants

persist in doing, that the effect and necessary operation of the statute is to take from them and give to the lessee. The statute is not capable of any such construction. Again the Court of Civil Appeals has adequately, if briefly, answered this contention. We quote, (R. 56): "The tax belongs to the State, and the mere fact that the producer is primarily liable for the payment of the tax, or the fact that the purchaser is required to collect the tax for the State at the source or origin does not give them any interest in the tax as against the royalty interests. They may have benefitted by the change of legislative policy of imposing the tax ratably against the respective interest holders in the oil produced; but such legislative tax policy did not impair any obligation of the lease contracts."

Elaborating somewhat on this clear statement, there has been no appropriation of appellants' property to the use or benefit of either lessee or purchaser; nor is that result possible under the act in question. All the tax for which they are liable goes to the State; and even its title is not complete until the termination of any suit they may elect to bring to test the validity of the law and the tax. The disputed tax remains in a special fund or account, deposited at interest for their benefit, to be refunded if their suit should be successful; otherwise to be covered into the State Treasury finally. Despite the attempt, apparently, to inject an element of misappropriation or confiscation into the case, the utter absence of any such vice is plain. The most that can be justly claimed by appellants is that they are now compelled to pay a part of the tax on the business, and that only because they are part own-

ers; whereas under the former law they would have had to pay no tax. What's wrong about that? Wherein does that deprive appellants of any right guaranteed by the Constitution of the United States? Surely it will not be contended that the parties could, as against the State, contract for immunity from taxation, present or future, or prevent the State from adjusting its tax system to what is later conceived to be in accordance with principles of private right and justice. Conceding that it was competent for them to contract that the lessee should bear the burden of appellants' taxes, as well as his own, and that they did so: the contracts, nevertheless, did not operate to restrain the State from levying a tax upon each owner, proportionately to his interest, and to collect it at the source. The matter of the enforcement of the contracts, as between the parties, is no concern of the State; their obligations, unimpaired by the act, remain as before. It becomes a mere matter of the proper interpretation of the contracts, if appellants should choose to demand a refund from producer or purchaser, as the case may be. In that controversy the State is not interested, nor can the enforcement of its tax laws be prevented, by any unfounded claim of contract impairment.

An additional word on alleged contract impairments. Quite aside from the consideration that the obligation, which appellants assert has been impaired, has no existence in fact, and forms no part of the contract, as we have attempted to show above, there is the further answer that the statute does not purport to and does not affect or impinge upon the contract as made by the parties. Effect upon any existing or future con-

tracts was not a legislative object, nor is there any evidence, intrinsic or otherwise, showing such a purpose. The contract, unaffected and unchanged, is not interferred with by the law; nor has there been any deprivation of remedy for its enforcement. The State courts properly reached these conclusions more fully stated above; there would be no excuse for elaboration.

In this relation, there is obviously no merit in the claim that because appellants, under a former law, paid no production tax on oil production, or on the business (a burden borne entirely by the lessee), they cannot now be made to bear their equitable share of the tax, under a new statute. The relation of appellants, by virtue of the leases, to the business in question is so real, so substantial that it affords a reasonable and just basis for the change in legislative policy. The prior immunity of appellants from any tax burden, either under existing statutes or under their contracts, is of no legal significance whatever. Neither is the voluntary assumption and payment by the lessee, as emphasized by counsel, under antecedent laws, at all important. Nor, as held by the Court of Civil Appeals, does the fact that the lessee is now required to pay one-eighth less of the tax than formerly, thereby increasing indirectly his net income, have any constitutional bearing, either under the due process clause or of that forbidding the impairment of contract obligations. That effect is only incidental, and is not an uncommon result of valid changes in taxing laws and systems. It is not, as often asserted by counsel: "taking one man's property and giving to another". It is not a taking at all; it is merely the adjustment of the State's

policy to obvious justice. It was never right to require the owner of only seven-eighth of a business to pay the entire tax for the privilege of pursuing it, or upon the production of it; at least it would appear that the Texas Legislature so concluded. Was there any vested right in the favored party to the continuance of that policy? Was the existence of *private* contracts securing such a right (if, in fact, they ever did), a constitutional obstacle to a change of public policy? We think the questions are answered by the mere statement of them.

Pages 20 to 27 of appellants' brief contain references to numerous cases, cited generally as illustrative of the limitations upon legislatures, the inconclusiveness of decisions of state courts and the right of independent inquiry by the Federal courts when Federal questions are involved. In deference to the zeal and ability with which Counsel has presented his cause, we concede a certain plausibility and persuasiveness in some of the general expressions employed and to his analysis. We insist, however, that a careful study of these cases will disclose that none is in point. Some we shall specifically differentiate; a generalization will suffice for the others.

We have not questioned and we shall not question the settled rules in this Court that state legislatures and Congress have no power, by mere designation, to declare a tax of one quality or character to have that of another; where the effect would be to deprive of constitutional rights. Nor that the effect of a law on rights secured by the Federal Constitution cannot be foreclosed by the decision of the state courts. Nor that

this Court decides for itself the nature and effect of a tax, regardless of the definition of it by the state court. Nor that the Legislature is without power to ignore substantial facts and convert, for taxing or regulatory purposes, a private carrier into a common carrier; a private business into a public utility, and the like, without regard to the essential facts. Nor to call a penalty or mere exaction a tax when plainly it is not. Nor that a congressional declaration that a certain Act regulated interstate commerce was effective, when it appeared that such was not its substantial effect. We simply say that this case presents no such unconstitutional aspects, and that it is not within any of the rules stated. The analogies, if any, are too remote.

The Texas cases cited, including Sheffield vs. Hogg (Tex. Sup.) 77 S. W. (2d), were considered by the Court of Civil Appeals and were regarded as presenting no obstacle to the validity and constitutionality of the statute. The Supreme Court of Texas, by denying a writ of error, in effect upheld this holding.

Appellants have cited and quoted from several decisions of this Court, in their brief and in their Statement as to Jurisdiction here. They are all thought to be distinguishable from the present case, and we shall point out the distinctions which occur to us in the principal cases cited. Other differentiations will doubtless occur to your Honors. If some of the general expressions quoted seem to give support to any of the contentions made by appellants, they do not apply here; and we must be pardoned for again recalling the maxim stated by Chief Justice Marshall in Cohens vs. Virginia, supra.

Presumably under their claim that they have been denied due process of law, and specifically that the tax here involved is a direct tax upon appellants' property right in the leased land, appellants cite Pollock vs. Farmers Loan and Trust Co., 157 U.S. 429. That case involved the validity of an act of Congress, imposing an income tax; and the tax was assailed as being a direct tax, violative of the apportionment and uniformity clauses of Article One of the Constitution. A further contention was that the tax was void because laid upon income from state and municipal bonds. The Court decided just two questions: 1. That the tax was a direct tax, as being a tax on rents or income of real property; and was void, as in violation of the Constitution. 2nd. As to the income from municipal bonds, the Act was void, on the ground that the United States have no power to tax either the instrumentalities or the property of a State. The chief controversy in that celebrated case seems to have raged about the distinction between "direct" and "indirect" taxes. Much was argued and much was written, but we have failed to discover anything of controlling significance here.

G. H. & S. A. Ry. Co. vs. Texas, 210 U.S. 217 merely decided that the Texas statute, levying the tax, was an attempt to regulate commerce among the states. The further incidental point, that the words "equal to" did not prevent the tax being an effort to reach the gross receipts, in part derived from interstate business, was also decided. No comment is necessary.

Flint vs. Stone Tracy Co., 220 U. S. 108, decided no more than that the "Corporation Tax", in the

Tariff Act of 1909, was not a direct tax but an excise. It is worthy of note, however, that in the opinion of the Court it was said that, while a mere declaration in a statute that a tax shall be regarded as of a particular character does not make it such, the declaration of the law making power is entitled to much weight. Other questions passed upon are manifestly irrelevant here.

Lake Superior Mines vs. Lord, 271 U. S. 577, decided that the Minnesota statute under attack was, in the absence of a decision by the State courts, a tax upon mineral estates in land; and that the statute did not offend the Fourteenth Amendment. If there be any persuasive features in the case, statutory differences and the fact that there had been no decision by the State courts, as to the character of the tax, lessen its force as a precedent. Much less is the actual decision, in the circumstances in which rendered and under the facts involved, a controlling influence in this controversy.

United States vs. Emery, 237 U.S. 28, involved the constitutionality of the Corporation Tax of 1909, as applied to a realty concern, whose only business was to keep up its corporate organization and to collect and distribute the rent received from a single lessee. It was held that the Company was not doing business within the meaning of the Act of Congress. Too remote, too remote!

Again presumably under due process, appellants cite Dawson vs. Kentucky Distilleries Co., 255 U.S., 288. The precise point intended, as we understand it, is

that a legislature cannot make a tax an occupation or license tax by merely calling it such—a proposition which we do not in the least controvert. The irrelevancy of the case appears from at least the following considerations:

The Kentucky statute there involved imposed a tax of fifty cents a gallon on whiskey withdrawn from bond or transferred in bond. Although termed an "annual license tax", it was not an occupation tax, but essentially a property tax, tested by the local law. Although levied on manufacturers of whiskey and those engaged in the business of owning and storing same in bonded warehouses, much of the whiskey affected was owned by citizens of other states, their ownership evidenced by negotiable warehouse receipts. The interpretation and validity of the statute had not, as here, been determined by any State court; hence the Federal courts felt free to decide the question upon the local law. It was held that the tax was essentially a property tax and, therefore, invalid under the Kentucky constitution. The facts showed that the act of various owners of bonded whiskey, in withdrawing it (the thing really taxed) had no relation to the business of buying and selling whiskey or otherwise using whiskey. The tax was imposed upon each lot of whiskey at the time of removal and the act of the owner in removing was actually the thing taxed. The emergency clause of the Act showed that the Legislature considered it was taxing the whiskey; hence, property. Is not the distinction manifest?

Upon impairment of contract obligations, appellants cite Murray vs. Charleston, 96 U.S. 432. These

grounds of differentiation from the case before the Court readily appear: The City of Charleston was a party to the contract, and it was its own contract the obligations of which were claimed to have been impaired. By its ordinances, the City sought to change the terms and obligations of its debt. The creditor was a non-resident owner and holder, he being a native of Germany. The Court, however, did not decide the effect, if any, of the creditor's being a non-resident holder of the credit involved.

Further, on the same points, appellants cite Cleveland P & A. R. R. Co., vs. Pennsylvania, 15 Wall., 82 U.S. 300. In that case the State of Pennsylvania sought to tax the interest on bonds of the Railroad Company, in the hands of non-resident holders. It was held that the bonds were property beyond the jurisdiction of the state; and that the alleged tax was but an exaction and forced contribution upon property held in other states. The difference is manifest.

Hartman vs. Greenhow, 12 Otto (102 U.S.) 672, was a case in which it appeared that the State of Virginia sought to avoid her own contract, whereby the State had contracted to receive coupons for all taxes to the State. The device of requiring the tax on her bonds issued under prior laws, to be deducted from the coupons originally attached to them, when tendered in payment of state taxes, was held to be an impairment of her contract with the bondholders and their assigns. The relation of the parties to the contracts alone suffices to distinguish. In any case, the decision is to be limited to the facts upon which it rested.

SUMMARY OF ARGUMENT

By way of recapitulation, and at the risk of repetition, we summarize our arguments as follows:

To appellants' claims that they have been denied due process of law, we reply:

That the statute under attack, together with the complementary remedial statute, passed at the same Session, affords due process to the fullest extent guaranteed by the Fourteenth Amendment. A speedy, adequate and comprehensive remedy is provided, in the specific provisions for a judicial hearing and review, extending to all legal questions which complaining taxpayers may see fit to raise. Pending the result of suits, the taxes paid under protest are held in a special account and placed at interest as are state funds, and at the same rate of interest. If the complainant is successful in his suit, his money with earned interest is returned to him. Considered remedially, the statutes would seem to meet every possible test of due process, within the meaning of the Fourteenth Amendment.

As to the substantive provisions, they deprive appellants of no constitutional right whatever. The taxes are laid for general revenue purposes and the burdens are distributed with fairness and equitably upon all subject thereto. The basic standard adopted is that of measuring the liability of every owner of a share in the gross production or business of producing oil, strictly according to his interest. Each is taxed ratably and in exact proportion to his ownership. There is no discrimination, no inequality, no confiscatory features, nothing arbitrary or capricious in the law, from caption to emergency clause. Wherein, then, have

appellants been deprived of any constitutional right?

The specific claim, so persistently advanced by counsel, that there has been a denial of due process, because the effect of the statute is to take from appellants a part of their property and to confer it upon the active producer in the business, is manifestly untenable. A casual reading of the statute will disclose no such purpose and no such effect. Not one cent of the taxes collected from royalty owners is for the use and benefit of the active producer or any other owner. It all goes to the state and to the state alone. We wish to be mindful of the amenities always, but the contention seems almost fanciful. It must rest, we think, solely upon the consideration that under former tax laws the active producer had been made to bear the entire burden of the tax, notwithstanding he might and usually did own less than the whole of the production; whereas under the new statutes he was made to pay the tax only according to his ownership; and the remainder, if any, is required to be borne by the other owners, according to interests. This, in effect, is to argue that a citizen without the purview of a taxing system at a given time, is, by some strange process of reasoning, protected by the Fourteenth Amendment from ever being brought within its burdens. In other words, that the Constitution gives him perpetual immunity from taxation, otherwise lawful and within state constitutional authority. The statement of the claim is its own refutation.

As to claims of impairment of contract obligations, we have several answers: First, we reply that the obligation said to have been impaired never had any existence. Neither the terms of the contract nor its im-

plications embraced the obligation of the lessee to pay the taxes here in dispute. The contention that they did rests wholly upon the clause in the contract that lessee should deliver to appellants their share of the oil produced "free of cost". Neither this phrase nor anything else in the contract indicates that the taxes of appellants, least of all taxes under laws not yet passed nor even contemplated by the Legislature, were thereby assumed by the lessee. The words must be taken in their usual and ordinary signification. So confined, they mean nothing more than the customary and usual costs incidental to the production of oil. They are not adequate to embrace a liability of the owners to the State for taxes. Such a charge has no relation to the production of oil, save as that activity or the business thereof affords the basis for the levy of the tax. It is not a cost incident to the production, as that term is commonly understood. Hence we say that there was no such obligation to be impaired.

Next, we say that, even if the payment of appellants' taxes could be said to be an obligation on the part of the lessee, by virtue of the terms of the contract, express or implied, the statute does not purport to impair or even affect that obligation. The contract remains as before, wholly unaffected and unimpaired. Such was the construction given by the Court of Civil Appeals, and so interpreted, all the constitutional rights of appellants were preserved and protected.

Finally, we conceive that appellants' contention goes to the indefensible point that the power of the state to tax is to be subordinated generally to private contracts, to which it is not a party; when the object

of the tax legislation is the raising of revenue from persons or property within her limits and under the authority of the State Constitution. Conceding, as we must, that the exercise of the taxing powers of the state is not beyond the restraints of the Federal Constitution, we contend, nevertheless, that when those powers are exercised in conformity with state constitutions and the taxes are levied upon property or persons within the state's jurisdiction and limits, the mere existence of antecedent private contracts does not, of itself, present any Federal question of contract impairments. Cases have been found and will continue to be found in which state taxing statutes must fall, because they impair the obligations of contracts; but all such will be seen to contain constitutional objections not here present. If such a convenient device, in private contracts, as the assumption by one party of the taxes of the other could operate, by force of the Federal Constitution, to exempt the latter from the tax laws of the state, we should expect to see the practice become very general. If by mutual agreement each party to a contract assumes and agrees to pay the taxes of the other, and the effect would be to deny the state the right to collect from either the taxes lawfully imposed upon them, because of resulting impairments of contract obligations, it is easy to see that the state would be seriously embarrassed in the raising of necessary revenue and in the devising of a tax system which should bear fairly and justly upon all alike. The Federal Constitution does not have and has never been given this meaning. We apprehend that the Court will not give it now. The power of the state to tax, within constitutional limits, extends to all persons and all prop-

erty within her borders; and is not to be circumvented by so easy a device as is here employed to accomplish that result.

Convinced that no constitutional right of appellants has been violated, under either the Fourteenth Amendment or the First Article of the Constitution, we pray that the judgment of the Court of Civil Appeals be in all things affirmed.

This argument is substituted for that made in our brief, heretofore filed, and we request the Court to consider it in that relation. We also ask the Court to give due consideration to the well considered opinions of the Court of Civil Appeals. (R. 45-57). We are sure they will be of aid in deciding some of the questions here.

Respectfully submitted,

WILLIAM MCCRAW,
Attorney General of Texas

H. GRADY CHANDLER,
LLEWELLYN B. DUKE,
Assistant Attorneys General

ATTORNEYS FOR APPELLEES